United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

76-7616

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P/S

United States Court of Appeals

For the Second Circuit

In Re Franklin National Bank Securities Litigation

ROBERT GOLD, on behalf of himself and on behalf of all others similarly situated,

Plaintiff-Appellant,

and

LOUIS PERGAMENT,

Intervenor-Plaintiff-Appellant,

against

ERNST & ERNST, HAROLD V. GLEASON, PAUL LUFTIG, PETER R. SHADDICK, MICHELE SINDONA, CARLO BORDONI, HOWARD D. CROSSE, ANDREW N. GAROFALO, DONALD H. EMRICH, and ROBERT C. PANEPINTO,

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF NEW YORK

REPLY BRIEF FOR PLAINTIFFS-APPELLANTS

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

IN RE FRANKLIN NATIONAL BANK SECURITIES LITIGATION	:	
ROBERT GOLD, on behalf of himself and on behalf of all others similarly situated,	:	
Plaintiff-Appellant,	:	No. 76-7616
-and-	:	
LOUIS PERGAMENT,	:	
Intervenor-Plaintiff-Appellant,	:	
-against-	:	
ERNST & ERNST, HAROLD V. GLEASON, PAUL LUFTIG, PETER R. SHADDICK, MICHELE SINDONA, CARLO BORDONI, HOWARD D. CROSSE, ANDREW N. GAROFALO, DONALD H. EMRICH, and ROBERT C. PANEPINTO,	:	
Defendants-Appellees.	:	

REPLY BRIEF FOR PLAINTIFFS-APPELLANTS

PRELIMINARY STATEMENT

Defendants and amici curiae ("the brokers") do not question the accuracy of plaintiffs' description of the manifold benefits which accrue to nominees from nominees'

concealment of the identities of beneficial owners (see plaintiffs' main brief, pages 13-16); nor do defendants or the brokers deny that the nominees have actively encouraged utilization of the nominee name system of registration (see plaintiffs' main brief, pages 9-11). Nevertheless, defendants and the brokers contend that the aggregate expenses incurred by several hundred nominees in identifying beneficial owners in this action -- an amount which may exceed $120,000.00 (see plaintiffs' main brief, pages 16-18) -- should be paid solely by class representatives rather than spread equitably among the nominees whose decisions to place the securities of others in their names actually created the need for a special and burdensome identification effort.

As shown below, such a result is mandated neither by Eisen v. Carlisle & Jacquelin, 417 U.S. 156 (1974) ("Eisen IV") nor by any other authority cited by defendants and brokers. Such authorities are fully consistent with the recognition that mailing a suitable notice to record owners fulfills individual notice requirements under Rule 23(c) of the Federal Rules of Civil Procedure and the due process clause of the United States Constitution. For the reasons presented below and in plaintiffs' main brief, the decision below should be reversed as to allocation of the expenses at issue.

POINT I

THE AUTHORITIES DISCUSSED BY DEFENDANTS AND BROKERS DO NOT SUPPORT THE CONCLUSION THAT PLAINTIFFS SHOULD BEAR THE COSTS AT ISSUE

(a) The Cases Cited By Defendants And Brokers Neither Hold Nor Suggest That Identification of All Beneficial Owners of Street Name Securities By Plaintiffs Would Involve No More Than A "Reasonable Effort" On Plaintiffs' Part

Defendants and brokers seek to create the impression that identification of street name purchasers by plaintiffs would not require an unreasonable effort of plaintiffs by citing various cases in which a notice program included provision for transmittal of class notices to beneficial owners of securities in street name or in which the court made a general statement to the effect that mere notice to brokers would not be sufficient. (See defendants' brief, pages 12-18; brokers' brief, page 11). However, both prior and subsequent to the Supreme Court's decision in Eisen IV, the courts have placed the responsibility for identifying beneficial owners of street name securities in class actions squarely upon the nominees. Even before Eisen IV plaintiffs frequently paid all or a part of the cost of preparing and mailing the notice to record owners and upon occasion were required at their own expense to mail the notice to additional beneficial owners after the nominees identified them. Nevertheless, to the best of plaintiffs' knowledge nominees

have, with one exception,* regularly borne the cost of identifying unregistered owners until the decisions herein and in Weiss v. Drew National Corp., No. 75 Civ. 4816 (S.D. N.Y., July 19, 1976).

Thus, in a number of pre-Eisen IV cases cited by defendants and brokers, nominees were required to identify beneficial owners and to provide plaintiffs with the relevant names and addresses so that plaintiffs could transmit the notice to the beneficial owners. E.g., Lamb v. United Security Life Co., 59 F.R.D. 25, 43 (S.D. Iowa, 1972); In re Memorex Security Cases, 61 F.R.D. 88, 103 (N.D.Cal. 1973); Herbst v. Able, 47 F.R.D. 11, 18 (S.D.N.Y. 1969), modified on other grounds, 49 F.R.D. 286 (S.D.N.Y. 1970); Berland v. Mack, 48 F.R.D. 121, 130 (S.D.N.Y. 1969). The class representatives' responsibility in such cases was not to identify the beneficial owners, but rather to apprise nominees of their responsibility by sending the nominees appropriate notices. If anything, such cases stand for the proposition that the Court may, either in the class notice or in a special notice to nominees, direct the nominees to

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* In Miller v. Alexander Grant & Co. [1971-72 Transfer Binder], CCH Fed.Sec.L.Rep. ¶93,287 (E.D.N.Y. 1971), the Court required defendants to absorb two-thirds of the cost of identifying beneficial owners in a context where, unlike many securities class actions, the court apparently found that the particular identification effort involved was not substantial. The Court stated that the cost "does not appear to be great and may be modest." (p.91,624)

undertake the identification effort because such effort is reasonable as to each nominee. It is in recognizing that class action notices should require nominees to take effective action to identify beneficial owners for the purpose of transmittal of such notices to beneficial owners that the courts gave effect to any statements that notice to the brokers without more would be insufficient. Plaintiffs submit that such purposes are achieved in full compliance with constitutional and statutory requirements by mailing the class notice to record owners and instructing the nominees to perform their fiduciary duty of retransmitting the notice to beneficial owners. E.g., In re National Student Marketing Litigation v. The Barnes Plaintiffs, 530 F.2d 1012, 1014, 1015 (D.C. Cir. 1976).*

Defendants note that the Supreme Court in Eisen IV determined that it was appropriate to require a review of

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* In Werfel v. Kramarsky, 61 F.R.D. 674, 682 (S.D.N.Y. 1974), cited by defendants, plaintiff expressed a willingness, if necessary, to pay the costs of identifying individual class members where the securities involved were bearer warrants transferable by delivery only -- a situation in which no registered owners and no nominees existed, and thus, no identification of class members whatsoever could occur without a program for identifying actual purchasers to be carried out by plaintiff or defendants.

brokers' records so that individual notice could be forwarded to those class members reasonably identifiable (defendants' brief, pages 12-13). Eisen IV was an antitrust action in which no identification of any class member (including registered owners) was possible without examination of brokerage firm records because the proposed class did not consist of purchasers of a particular security but rather of all persons who traded in odd lots of securities on the New York Stock Exchange. The option in Eisen IV was thus either for someone to examine brokerage records or to totally dispense with individual notice to any class member.

Moreover, the Supreme Court in Eisen IV did not concern itself with allocating responsibility for the effort of examining brokerage records and in no way addressed itself to the further questions of (a) whether analysis of the records involved had to extend beyond identifying record owners; and (b) allocating responsibility for the work and expense of identifying beneficial owners of nominee name securities if such identification was necessary. The estimated cost of individual notice in Eisen IV represented only the cost of "stuffing and mailing each individual notice form" (417 U.S. at 167). Consequently, Eisen IV does not represent any expression by the Supreme Court with respect

to whether or not it is reasonable to require plaintiffs to undertake the burden of identifying all beneficial owners of street name securities or to pay the cost of such identification effort, and in Eisen IV such expenses were not treated as plaintiffs' responsibility.

Decisions since Eisen IV bear out the above analysis. E.g., In re National Student Marketing Litigation v. The Barnes Plaintiffs, 530 F.2d 1012, 1014, 1015 (D.C. Cir. 1976) (individual notice was mailed by plaintiffs to shareholders of record; brokerage firms retransmitted notices to beneficial owners); In re Four Seasons Securities Laws Litigation, 63 F.R.D. 422, 427, 430 (W.D.Okla. 1974), aff'd, 525 F.2d 500 (10th Cir. 1975) (nominees had the option of providing identities of street name customers to trustee in bankruptcy or forwarding copies of notice provided by class plaintiffs to beneficial owners). While defendants seek to distinguish In re National Student Marketing Litigation and In re Four Seasons Securities Laws Litigation from the present situation (see defendants' brief, pp. 25-26), the courts involved did in fact hold that a method of notice in which plaintiffs did not have the responsibility for identifying the beneficial owners of street name securities and individual notice was mailed by plaintiffs only to record

owners was appropriate and fully consistent with Eisen IV. E.g., In re National Student Marketing Litigation, supra, 530 F.2d at 1014-1015; In re Four Seasons Securities Laws Litigation, supra, 63 F.R.D. at 427, 430 and 525 F.2d at 503.

In Jahre v. Rait, 74 Civ. 805 (E.D.N.Y.), Judge Weinstein on October 16, 1976 did vacate his order requiring nominees to identify beneficial owners of street name securities without reimbursement, but on October 20, 1976 Judge Weinstein signed an order providing that "under all of the circumstances, prior efforts to notify potential class members are adequate and no further notice need be sent to potential class members...." Since the order recites that prior individual notice to class members of the pendency and settlement of the class action was limited to "sending notices and related documents to all record owners," Judge Weinstein's order reflects a determination that mailing the notice only to record owners was sufficient individual notice under Eisen IV and complied with due process requirements under the federal constitution. A copy of Judge Weinstein's October 20, 1976 order is annexed hereto as Exhibit A.

Nor do Popkin v. Wheelabrator-Frye, Inc. [1975-1976 Transfer Binder] CCH Fed.Sec.L.Rep. ¶95,411 (S.D.N.Y.

1976) or Frankenstein v. McCrory Corp., 74 Civ. 727 (S.D.N.Y., Order of November 14, 1975) support defendants' and brokers' position. In Popkin, Judge Cannella held only that the class representatives' responsibility under Rule 23(c)(2) required plaintiff to mail to non-responding nominees a supplementary notice and order requiring them to identify beneficial owners of street name securities or to justify their refusal to the Court. Nothing in the Popkin decision indicates that Judge Cannella placed upon class representatives the overall responsibility for identifying beneficial owners as opposed to the responsibility to bring to nominees' attention their duty to identify the beneficial owners. In Frankenstein v. McCrory Corp., supra, plaintiffs stipulated that they would reimburse objecting brokers for their reasonable costs and expenses, and thus Frankenstein does not serve as precedent with respect to the issue at hand.

Defendants' reliance on Girsh v. Jepson, 521 F.2d 153 (3rd Cir. 1975) and Entin v. Barg, 412 F.Supp. 508 (E.D.Pa. 1976), a case which relies on Girsh for its result, is also misplaced. Girsh did not consider the question whether mailing a notice to all record owners for the class period (with instructions to nominees to re-transmit the notice) was sufficient, but simply held that limiting indi-

vidual notice to persons who were record owners as of the close of business on three specific dates during a class period of more than a year's duration was improper. Defendants cite Entin v. Barg, supra, as a case in which the Court required special efforts by plaintiff to identify purchasers of street name securities. However, the Court in Entin v. Barg did not require plaintiffs to bear the responsibility of identifying street name purchasers, but rather required the nominees to identify and transmit notices to the beneficial owners. Additional efforts were undertaken to determine the addresses of beneficial owners only as to those beneficial owners whose names and last known addresses had been determined by the nominees and as to whom notices transmitted by the nominees were returned as "undeliverable." 412 F.Supp. at 512.

(b) The Nominees May Properly Be Required to Compile Data At Their Own Expense to Aid in the Identification of Beneficial Owners of Nominee Name Securities

Contrary to the brokers' argument (see brokers' brief, pp.23-28), applicable principles under the discovery rules are consistent with requiring nominees to identify the beneficial owners of nominee name securities at their own expense.

If, as the brokers argue, decisions under Rule 45

concerning discovery against third-parties by subpoena are applicable by analogy, the nominees should do the work and bear the expenses involved. Under Rule 45 third-parties may be required to compile information at their own expense when the costs involved are more fairly allocated to the third-parties than to the party requesting discovery either because the costs involved are properly considered overhead expenses necessary for responding to legitimate court orders, because the relative burden to the requesting party would be far greater than the relative burden to the producing party, or because a public interest aspect to the litigation* makes it appropriate for third-parties to bear their own expenses. E.g., United States v. Int'l Business Machines Corp., 62 F.R.D. 507, 510, 511 (S.D.N.Y. 1974); Blank v. Talley Industries, Inc., 54 F.R.D. 627 (S.D.N.Y. 1972). Furthermore, as Professor Moore points out, the language of Rule 45(b) "suggests that the cost may be shifted [to the requesting party] only if the subpoena is unreasonable or oppressive...." 5A Moore, Federal Practice, ¶45.05[2], page 45-50, ftn. 45 (2d ed. 1975).

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* In this connection the public interest in preservation of securities class actions as a device for protection of investors is a significant consideration.

In the present instance, the unfairness of shifting the effort or costs involved from the various nominees to the class representatives is especially compelling since the nominees themselves have created the need for a special program to identify beneficial owners by encouraging the utilization of a system which conceals the beneficial owner's name for the nominee's own benefit. Moreover, "[i]nconvenience is relative to size" (Application of Radio Corp. of America, 13 F.R.D. 167, 172 (S.D.N.Y. 1952)), and the effort and expense to be imposed upon plaintiffs would be far more burdensome to plaintiffs than the effort and expense required of each nominee would be to the nominees.

While the brokers maintain that interpretations of Rule 45 of the Federal Rules of Civil Procedure provide the proper analogy on the ground that nominees are third-parties, nominees are not the "strangers" to this litigation the brokers purport them to be. The institutions involved may well be beneficial owners of Franklin securities as well as nominees, and thus stand to benefit in their own right from the class action. Even those nominees who were not themselves beneficial owners acquired and registered Franklin shares as agents for customers and thus are "properly the objects of the...[class] notice" (Greenfield v. Villager

Industries, Inc., 483 F.2d 824, 829 (3rd Cir. 1973)). Consequently, plaintiffs submit that nominees are affected by this litigation in a manner analogous to parties and should be treated in a manner similar to that accorded a party on questions of allocating the effort and expense of discovery.

Under such principles, nominees must bear their own expenses of responding to discovery requests unless they can demonstrate "undue burden or expense" (Federal Rules of Civil Procedure, Rule 26(c)) and must compile discoverable information requested except in situations where it is appropriate to disclose the documents from which the information can be compiled in lieu of extracting the information. See Rule 33(c). While, as the brokers note, certain cases have held that a party may not require his opponents to prepare interrogatories requiring unduly burdensome extraction of information from documents in the responding parties' possession, courts have required the responding party to perform the compilation himself at his own expense if the requesting party is unfamiliar with the type of records involved, the records themselves include a large amount of material and the requesting party cannot efficiently and effectively perform the work required. E.g., Foster v.

Boise-Cascade, Inc., 20 F.R. Serv.2d 466, 470 (S.D.Tex. 1975); United States v. 58.16 Acres of Land, 66 F.R.D. 570, 573 (E.D.Ill. 1975); Chrapliwy v. Uniroyal, Inc., 17 F.R.Serv.2d 719, 722 (N.D.Ind. 1973).

Indeed, much of the relevant information is computerized, with the result that a compilation of relevant information by the brokers would inevitably be required regardless of whether the appropriate analogy is to Federal Rule 33, 34, or 45. In 1970 Federal Rule 34(a) was amended specifically to require a party to prepare and produce compilations of information from computerized data by defining "documents" to include:

> "other data compilations from which information can be obtained, translated, if necessary, by the respondent through detection devices into reasonably usable form."

According to Wright and Miller, under Rule 34:

> "The responding party who is required to prepare a printout or otherwise make the data reasonably usable for the discovering party must ordinarily bear the expense of doing this. He can shift the cost to the discovering party only on a showing under Rule 26(c) that justice so requires in order to protect himself from 'undue burden or expense.'" 8 Wright & Miller, Federal Practice & Procedure §2218, p.659 (1970) (footnote omitted).

While the Advisory Committee which drafted the 1970 amendment recognized that in appropriate instances undue burden to the respondent should lead to a shifting of costs (see 48 F.R.D.

487, at 527), such undue burden does not exist in the present situation because (a) the nominees themselves have created the need for a special effort to determine the identities of beneficial owners by utilizing the nominee name system for their own purposes and benefit, and (b) the relative financial burden to class representatives if they were to absorb the expense of identifying all beneficial owners would be far greater than the relative financial burden to the individual nominees for identifying only those beneficial owners listed in their own files.

Sanders v. Levy, ___F.2d___, 21 F.R.Serv.2d 1213 (2d Cir., June 30, 1976), rehearing en banc pending, does not contain any holding inconsistent with the above analysis. While the majority opinion in Sanders questioned whether plaintiffs would not be required to absorb the expenses at issue if the outcome depended on application of the discovery rules, the majority expressly stated that "we do not rely on this point since we find the discovery rules inapplicable." 21 F.R.Serv.2d at 1218. Consequently, the majority mentioned the relevant principles under the discovery rules in Sanders only in passing; relied on cases under Rule 33 (rather than Rule 34 which expressly deals with computerized information) without considering the line

of cases noted above which refuse to allow parties to produce a mass of records in lieu of compiling information when the requesting party cannot efficiently and effectively perform the compilation himself; and did not, of course, address itself to the question whether it would be more equitable to require the various nominees or class plaintiffs to pay the costs of identifying beneficial owners of street name securities. Plaintiffs also submit that the statement by the majority in Sanders that "[s]ince the Fund has no direct interest in the outcome of the class action claim, it is too remotely involved to have notification costs imposed upon it" (21 F.R.Serv.2d at 1216) was not a statement concerning the outcome of the issue under the discovery rules. Rather, such statement was included in that portion of the majority opinion which explains why the relationship between plaintiffs in Sanders and the Fund did not justify an exception to the Eisen IV rule that plaintiffs must initially bear notification costs.

(c) The Rules Cited by Defendants and Brokers Which Deal With Reimbursement of Brokers Or Third-Parties Deserve Little Weight in Resolving The Issue At Bar

Defendants and brokers also rely by analogy upon Rule 14a-3(d) of the Securities and Exchange Commission

("the SEC") and various rules of stock exchanges which deal with the brokers' transmission to current customers of proxy materials, interim reports, and other materials provided to brokers by issuers or proxy solicitors and which provide for reimbursement to the record holders for such transmissions. E.g., brokers' brief, pages 33-37. Such rules deal with a significantly different factual situation from the case at bar and thus deserve little weight in the resolution of the issue at hand.

In the first place, as the brokers themselves repeatedly emphasize, the process of identifying beneficial owners of securities who are currently customers of the nominee involved is much less burdensome and expensive than the process involved in identifying class members who are former customers of the nominee. Such expenses may well be considered a regular cost of doing business for issuers and are sufficiently minimal in amount not to impose a significant burden regardless of whether the issuer or the broker absorbs such cost.* Consequently, such rules deal with a

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* Thus, the New York Stock Exchange has approved the following as fair and reasonable rates of reimbursement for all out-of-pocket expenses (not including postage) incurred in connection with proxy solicitations pursuant to New York Stock Exchange Rule 451, and in mailing interim reports or other material pursuant to Rule 465: $.50 for each set of proxy materials for meetings which do not include a proposal requiring beneficial owner instructions; $.60 for each set of proxy materials which include a proposal requiring beneficial owner instructions; and $.10 for each copy of interim reports or other material. CCH New York Stock Exchange Guide ¶2451.90.

situation materially different from the present case where costs for a different kind of investigative activity cumulating far in excess of the costs involved under the SEC and stock exchange rules are involved; where the cost can in no way be considered a part of a class representative's regular "cost of doing business;" and where the relative burden to the class representatives is infinitely greater than the relative burden to the individual nominee. Consequently, the equities argue more strongly in the present instance for having the brokers absorb their own costs than they do in the case of proxy type material from issuers. See Blank v. Talley Industries, Inc., supra.

The Supreme Court has held that the mere fact of SEC approval of stock exchange rules does not authorize unfair treatment of non-members by the exchange even when such treatment is in compliance with stock exchange rules. In Silver v. New York Stock Exchange, 373 U.S. 341, 349-54 (1963), the Supreme Court stated:

> "Congress in effecting a scheme of self-regulation designed to insure fair dealing cannot be thought to have sanctioned and protected self-regulative activity when carried out in a fundamentally unfair manner." Id. at 364. (footnote omitted)

It must be recognized that the stock exchange rules cited by defendants and brokers represent self-protective provisions rather than self-regulation by the securities industry for

the public interest. In light of the history of concern that without public supervision and susceptibility to public criticism the stock exchanges may act to protect their members rather than serve the public interest (see e.g., II Loss, Securities Regulation, pp. 1165-1167, 1179-1183 (2d ed. 1961), and V Loss, Id. pp. 3144-3149 (1969 Supp. to Vol. II), the Securities Exchange Act of 1934 ("1934 Act") established a procedure for public notice of proposed stock exchange rules so that the public will have a right to present its position with respect to such rules prior to SEC approval of such rules. E.g., 1934 Act, §19(b). The rules cited as analogies herein by brokers do not deal with the rights and responsibilities of brokers vis-a-vis class representatives in securities class actions, and in consequence such rules were drafted and approved without any public input with respect to their relevance to such a situation.*

The brokers also suggest that the Tax Reform Act of 1976 embodies the principle that third parties should be

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* Nor, it should be noted, did class action representatives have any occasion or opportunity to challenge SEC Rule 14a-3(d) when it was proposed, since the Rule only purported by its terms to affect issuers, not individuals such as plaintiffs herein.

reimbursed for costs such as the costs at issue. While the recent tax code amendments to which the brokers refer authorize (but do not require) the Internal Revenue Service ("IRS") to establish rates and conditions under which reimbursement for costs in complying with certain types of summonses may be obtained, the recent amendment expressly does not authorize the IRS to establish a basis for reimbursing third party costs in certain instances analogous to the present situation. Thus, reimbursement is not authorized if the purpose of the summons is to determine the identity of a person having a numbered account at a bank or other specified institution or if the summons is in aid of collection of liability of any person against whom an assessment has been made or a judgment rendered. See, Internal Revenue Code of 1954, as amended, 26 U.S.C. §§7609(c)(2); 7610(a) (P.L. 94-455, Section 1205(a)). Consequently, plaintiffs submit that the Tax Reform Act of 1976 represents no clear cut statement of policy by the Congress with respect to the appropriate allocation of costs in the present case where the need for special investigative costs arises because nominees have for their own purposes created a system which conceals the names of beneficial owners and where, as shown above, the nominees are not really "strangers" to the litigation.

(d) Nominees Have a Fiduciary Responsibility to Transmit Class Notices to Beneficial Owners Regardless of Whether or Not the Beneficial Owner is a Customer of The Nominee at the Time the Nominee Receives Notice

The brokers err in arguing that their duties as agents of customers to transmit notices terminates once the customer ceases to do business with the broker. See brokers' brief, pages 29-31. According to the Restatement (Second) of Agency, §381 (1958):

> "Unless otherwise agreed, an agent is subject to a duty to use reasonable efforts to give his principal information which is relevant to affairs entrusted to him and which, as the agent has notice, the principal would desire to have and which can be communicated without violating a superior duty to a third person."

Comment (f) to Section 381 specifically recognizes that

> "[a]n agent may be under a duty to give information to the principal after the termination of the agency, as where he does not account to the principal until such time."

See also, Restatement (Second) of Agency, §382, including comment (d) (duty to keep and render an account); §396 (other duties which survive termination). An agent's duty to communicate material information to his principal is inferred even if the agent has not specifically been instructed to communicate such information. E.g., Id. §381, comment (a).

Thus the fact that certain class members are no longer a nominee's customers does not terminate the nominees'

duty to transmit the notice to such former customers. By placing Franklin New York Corporation ("Franklin") securities in nominee name, nominees encouraged their customers to believe that the nominees would transmit to them important notices concerning such securities. Since the nominees and customers both understood that the nominees might on occasion have to serve as intermediaries with respect to information concerning Franklin even after customers ceased to have accounts with them, the nominees have encouraged their former customers to continue to place their trust in them to carefully forward such information. Such foreseeable reliance by former customers on the care and good faith of nominees creates a continuing fiduciary responsibility to former customers to inform them of class notices.*

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* The case of Robinson v. Merrill Lynch, Pierce Fenner & Smith, Inc., 337 F.Supp. 107, 111 (N.D.Ala. 1971), cited by the brokers at page 31 of their brief to support their argument that no fiduciary duty lasts beyond the broker's execution of a purchase or sale pursuant to his customer's order, is wholly inapposite. Robinson did not concern the responsibilities of a nominee to transmit communications specifically addressed to former customers, but merely held that a commodities broker who was not an investment adviser had no duty to inform his customer on a continuing basis of all information coming to his attention which might conceivably affect the desirability of the customer's market position.

(e) Defendants' Argument that Without Reimbursement to Brokers the Notice is Unlikely to Reach Beneficial Owners is Unsupported by the Record and Misconstrues Individual Notice Requirements Under Rule 23

While defendants argue that plaintiffs are on notice that the brokers will refuse to transmit class notices to beneficial owners despite a statement in the class notice instructing nominees of their duty to transmit the notice to beneficial owners, the participation of the brokers in this and other actions supports the conclusion that nominees are deeply concerned that they will violate an obligation to customers or former customers by refusing to transmit class notices and in consequence are seeking court decisions which will shift the responsibility from them to class representatives.* While defendants refer to the "attitude" of the securities industry as exemplified by E.F. Hutton & Co.

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* Were the brokerage industry as confident as the amici curiae herein purport to be that they have no fiduciary responsibility to transmit notices to former customers and that statements in a class notice instructing them of their duty to transmit such notices have no legal effect, it is questionable whether brokers would have mounted their present nationwide campaign to require class representatives to bear such costs as reflected in their brief herein and in their activities in Jahre v. Rait, and the Ampex and Penn Central litigations as described in plaintiffs' main brief on pages 16-18.

in the Ampex litigation, E.F. Hutton & Co. did not in fact refuse to transmit the notice, but applied to the court for reimbursement of the expenses it would incur in identifying beneficial owners. That request was denied (see plaintiff's main brief, page 32) and nothing in the record indicates that E.F. Hutton & Co. will not comply with the decision of the court in the Ampex litigation.

It should be noted that an important function of the provision in the class notice instructing nominees to retransmit the notice to beneficial owners is that it puts the nominee on notice that it is receiving information disseminated to it because of its prior activities as agent for a customer or former customer, which information is clearly of material importance to any former customer. The instruction in the class notice thus serves both to assure that the beneficial owner will have a remedy against the nominee for damages sustained if the nominee does not retransmit the notice and to alert the nominee to his obligations.

Defendants' argument that a Court order directing nominees to retransmit the notice without reimbursement cannot effectively be enforced (defendants' brief, pp.24-25) misconceives the notice requirements of Rule 23(c). Under

the Rule, the Court must direct "the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort." Defendants incorrectly assume that under Rule 23 plaintiffs must in effect guarantee that notice is in fact received by all beneficial owners of street name securities who could be identified by nominees. Plaintiffs submit that the notice program which they have proposed is the best program "practicable under the circumstances" consistent with a reasonable effort by plaintiffs. In consequence, this program is consistent with the requirements of Rule 23(c) and (contrary to defendants' argument) no questions concerning the manageability of the lawsuit arise.

(f) Defendants and Brokers Fail to Meaningfully Distinguish the Authorities Cited By Plaintiffs

Defendants and brokers argue that two of the cases cited by plaintiffs in their main brief, In re Penn Central Securities Litigation, 416 F.Supp. 907 (E.D.Pa. 1976), appeal pending, No. 76-2139 (3rd Cir., filed July 19, 1976) and Judge Williams' oral ruling in Kushner v. Ampex Corp., No. C 72-360 (N.D.Cal. November 15, 1976) are inapposite because those cases involved applications by brokers for reimbursement out of existing settlement funds which would

have an impact on the entire class, whereas the expenses here at issue would be borne by the class representatives at least initially. Such attempted distinction is insufficient.

First, to the extent that defendants' and brokers' argument relies on the contention that the Court may not properly impose the costs at issue on nominees, the existence or non-existence of a settlement fund is irrelevant. The courts in Penn Central and Ampex clearly held that brokers were not entitled to be reimbursed for such costs, and that the brokers or their customers properly bore the expenses of identifying beneficial owners. Second, defendants' argument that the costs at issue in this action are not being imposed on the class (as would have been the case in Penn Central and Ampex under the brokers' proposal) but only on class representatives is irrelevant to the question whether such costs are equitably imposed on class representatives. Third, a decision that class representatives must initially bear the costs involved would result in reimbursement of such outlays to the class representatives from any eventual settlement fund as administrative expenses and thus result in the imposition of such costs on class members generally without regard to whether or not the individual class member placed his stock in street name.

Defendants and brokers also argue that the Penn Central decision is unsound because Judge Lord failed to clearly recognize the significant percentage of securities which are held in street name. The issue is not, however, what percentage of all relevant securities are held in nominee name, but rather the unfairness of requiring either the class representatives or the class as a whole to bear special expenses which are required only because some but not all class members, with their brokers' encouragement, chose to place their securities in nominee name.

The brokers also err in attempting to distinguish Blank v. Talley Industries, Inc., supra on the ground that such decision involved the imposition of a less costly procedure on only one broker. Judge Gurfein expressly based his decision on a concern over the cumulative impact of such costs on plaintiffs in a context where numerous other brokers might also request reimbursement:

> "In view of the number of brokerage firms involved in plaintiffs' court-ordered quest for class members' identities, it would be unfair to compel the plaintiffs to cover the costs of the firms' production of information, which costs when cumulated would indeed be burdensome." 54 F.R.D. at 627

(g) Defendants Have No Valid Interest in the Allocation Of the Costs at Issue Because Plaintiffs' Proposed Notice Program Provides Adequate Protection Against Collateral Attack of a Future Judgment

Defendants also argue that plaintiffs should have to reimburse nominees for identifying beneficial owners to forestall the possibility of collateral attack by beneficial owners who may not personally receive the Notice of Pendency.* However, the method of notice proposed by plaintiffs provides adequate protection against collateral attack because such method is the best practicable under the circumstances and is designed to provide individual notice to all class members who can be identified with reasonable effort. See, e.g., In re National Student Marketing Litigation v. The Barnes Plaintiffs, supra, and In re Four Seasons Securities Laws Litigation, supra, rejecting collateral attacks by street name shareholders and emphasizing that the method of notice employed -- which was consistent with that proposed by plaintiffs herein --was proper under Rule 23 and met constitutional requirements.

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* Similar arguments are routinely made by defendants who oppose class action certifications on grounds such as an alleged lack of adequacy of class representation, and courts have recognized that "the implicit objective of their [i.e., defendants] arguments is to insure no representation at all." Clark v. Cameron-Brown Co., 72 F.R.D. 48, 55 (M.D.N.C. 1976). See also, Umbriac v. American Snacks, Inc., 388 F.Supp. 265, 275 (E.D.Pa. 1975).

Defendants' reliance on Greenfield v. Villager Industries, Inc., supra, is misplaced. In Greenfield the Third Circuit vacated the settlement because notice of settlement had been limited to notice by publication (which itself was "scanty") and had allowed insufficient time for response to the notice. 483 F.2d at 833-834. Moreover, the Greenfield opinion both suggests that individual notice to record owners would have been sufficient individual notice (483 F.2d at 830) and assumes brokers will in fact retransmit the notice to beneficial owners of street name securities. 483 F.2d at 834.

POINT II

THE THRUST AND PURPOSE OF DEFENDANTS' POSITION IS TO UNDERMINE AND CRIPPLE SECURITIES CLASS ACTIONS AS AN INSTRUMENT FOR PROTECTING INVESTORS

Pages 34 and 35 of defendants' brief reveal that the real purpose behind defendants' position is to deter the commencement of securities class actions. Defendants express concern for "irresponsible" plaintiffs commencing "frivolous" actions with "postage stamp pleading."* However, defendants are in fact seeking to impose a massive financial burden not on plaintiffs in some mythical action

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* See A21-A44 for the amended complaint herein.

but in the present lawsuit, a litigation involving losses to investors flowing from a major bank failure which has already given rise to criminal convictions of several of the defendants named herein. The present case is in fact an excellent example of the important role played by class actions as an instrument for protecting investors. See, e.g., cases cited in plaintiffs' main brief, pages 45-47. No controlling or persuasive authority exists which would require this Court to adopt defendants' argument with its crippling implications for securities class actions.

CONCLUSION

For the reasons stated above and in plaintiffs' main brief, the Court should reverse the orders of October 27, 1976 and November 30, 1976 insofar as those orders require plaintiffs to reimburse nominees for their expenses of identifying beneficial owners of nominee name securities.

Dated: New York, New York
March 25, 1977

Respectfully submitted,

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EXHIBIT A

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

----------X

J. IRVING JAHRE,

Plaintiff,

-against-

JOSEPH M. RAIT, PROFLEX LIMITED and PELOREX CORPORATION,

Defendants.

----------X

Index No. 74 Civ. 805 (J.B.W.)

ORDER

WHEREAS, on petition to annul, vacate or modify this Court's Order of May 19, 1976, directing banks, brokerage firms or other nominees holding Pelorex Corp. common stock as record owners, to transmit to their beneficial owners, without reimbursement, a copy of the Stipulation of Settlement, Notice to class members and proof of claim, the Court has vacated such Order, and

WHEREAS, Defendant Pelorex Corp. has heretofore sought to notify potential class members of the approval of the settlement agreed to herein and of the pendency of this class action by sending notices and related documents to all record owners of Pelorex common stock for the period February 16, 1971 through March 31, 1973 and by publishing three separate notifications to potential class members in editions of The Wall Street Journal, and

(95)

WHEREAS, based upon statements of counsel made orally in court indicate that further efforts to notify potential class members will constitute a substantial financial bur on Defendant Pelorex Corp., it is

ORDERED, that, under all of the circumstances, prior efforts to notify potential class members are adequate and no further notice need be sent to potential class members, and it is further

ORDERED, that the final date for filing proofs of claim is extended to and including October 29, 1976.

UNITED STATES DISTRICT JUDGE

October 20, 1976

THE FOREGOING ORDER IS HEREBY CONSENTED TO:

LAWLER, KENT & EISENBERG

By _____
Leonard J. Rubin

RUBIN BAUM LEVIN CONSTANT & FRIEDMAN

By _____
A Member of the Firm

STATE OF NEW YORK)
: ss.:
COUNTY OF NEW YORK)

Judith Goodhart, being duly sworn, deposes and says that she is in the employ of Milberg Weiss Bershad & Specthrie, attorneys for the within Plaintiff-Appellant, Robert Gold herein, and is over the age of 21 years.

On the 25th day of March, 1977 deponent served the two copies of the with Reply Brief for Plaintiffs-Appellants upon the attorneys for the respective parties named on the attached list by depositing a true copy of the same to each of them, securely enclosed in a postpaid wrapper in a post office box regularly maintained by the United States Government at One Pennsylvania Plaza, New York, New York, directed to each of them at their respective addresses set forth below, those being the addresses within the State designated by them for that purpose on the preceding papers in this action, or the places where they then kept their respective offices between which places there then was and now is a regular communication by mail.

Judith Goodhart
JUDITH GOODHART

Sworn to before me this

25th day of March, 1977.

Linda S. Baker
Notary Public

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Notary Public, State of New York
No. 43-4613498
Qualified in Richmond County
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ATTACHMENT "A"